

BEFORE THE SECURITIES COMMISSIONER

STATE OF COLORADO

Case No. XY 2013-\_\_\_\_\_

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**NOTICE OF DUTY TO ANSWER, NOTICE TO SET, NOTICE OF HEARING, AND  
NOTICE OF CHARGES**

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IN THE MATTER OF JEFF M. WILSON and WILSON ADVISORY GROUP, LLC,

Respondents.

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TO: Mr. Jeff M. Wilson  
390 Union Blvd., Suite 310  
Lakewood, Colorado 80228

Mr. Jeff M. Wilson  
6740 East Cedar Avenue, Unit B  
Denver, Colorado 80224

Wilson Advisory Group, LLC  
390 Union Blvd., Suite 310  
Lakewood, Colorado 80228

Daniel J. Levin, Esq.  
Levin & Jacobson, LLC  
950 South Cherry Street, Suite 912  
Denver, Colorado 80246

**NOTICE OF DUTY TO ANSWER**

**YOU ARE HEREBY NOTIFIED** that pursuant to § 24-4-105(2)(b), C.R.S., you are required to file a written answer to the following Notice of Charges set forth below with the Office of Administrative Courts, 633 Seventeenth Street, Suite 1300, Denver, Colorado 80202, within **thirty (30)** days after the mailing date of this Notice of Duty to Answer, Notice to Set, Notice of Hearing, and Notice of Charges (collectively "Notice of Charges"). You **must** also mail a copy of such answer to the attorney of record in this matter for the Colorado Division of Securities, Sueanna P. Johnson, Assistant Attorney General, Office of the Attorney General, The Ralph L. Carr Judicial Building, 1300 Broadway, 10<sup>th</sup> Floor, Denver, Colorado 80203, within the same thirty-day time period.

If you fail to file your written answer within thirty (30) days as set forth above, then an order entering a default decision may be issued against you. You are further advised that

issuance of a default decision may grant the relief requested in the Notice of Charges, or such other relief or penalties that may be provided for by law, or both.

### **NOTICE TO SET**

**YOU ARE HEREBY NOTIFIED** that the undersigned attorney or a representative of the Securities Commissioner, will appear on **Wednesday, March 22, 2013 at 9:45 AM** at 633 Seventeenth Street, Suite 1300, Denver, Colorado 80202, in order to set the date, time and location for a hearing regarding the Notice of Charges set forth below. You may be present in person or by counsel, or you may make prior arrangements to be reached by telephone at the time and date specified above by contacting the Office of Administrative Courts at (303) 866-2000 prior to the day of setting.

### **NOTICE OF HEARING**

**YOU ARE HEREBY NOTIFIED** that, pursuant to §§ 11-51-606(1), 24-4-104 and 24-4-105, C.R.S., a hearing will be held before an authorized administrative law judge at a date, time and location to be determined pursuant to the above Notice to Set. At the hearing, testimony will be taken and other evidence will be received by the administrative law judge for the purpose of determining whether any of the sanctions set forth in § 11-51-410(1), C.R.S. should be imposed upon you, including but not limited to, suspension, revocation or other conditions imposed upon the investment advisor representative license of Jeff M. Wilson, who conducts business as an Investment Advisor under the name of Wilson Advisory Group, LLC, based upon the violations set forth in §§ 11-51-401 and 410, C.R.S., and 3 CCR 704-1, Rule 51-4.8 (IA).

**YOU ARE FURTHER NOTIFIED** that at the hearing in this matter, you shall have the right to appear in person and/or by legal counsel, to present evidence on your own behalf, to cross-examine any witnesses, and to rebut any evidence presented. You may also have subpoenas issued on your behalf upon request to the administrative law judge. A copy of the General Rules of Procedure may be obtained at the Division of Administrative Hearings or by visiting their Internet web site at: [http://www.colorado.gov/dpa/oac/gs\\_procedural\\_rules.htm](http://www.colorado.gov/dpa/oac/gs_procedural_rules.htm).

### **RELEVANT LEGAL AUTHORITY**

The following statutes and rules are relevant to the allegations and charges made in the Notice of Charges:

#### **§ 11-51-410. Denial, suspension, or revocation.**

(1) The securities commissioner may by order deny an application for a license, suspend or revoke a license, censure a licensed person, limit or impose conditions on the securities activities that a licensed person may conduct in this state, and bar a person from association with any licensed broker-dealer, investment adviser, or federal covered adviser in the conduct of its business in this state in such capacities, and for such period as the order specifies. These sanctions may be imposed only if the securities commissioner makes a finding, in addition to the findings required by section 11-51-704(2), that the applicant or licensed person or, in the case of a broker-dealer or investment adviser, a partner, officer, director, person occupying a similar status

or performing similar functions, or person directly or indirectly controlling the broker dealer or investment adviser:

...

(b) Has willfully violated or willfully failed to comply with any provision of this article, or any rule or order under this article ...

**Rule 51-4.8(IA).A., CCR 704-1 Dishonest and Unethical Conduct**

A person who is an investment adviser or investment adviser representative is a fiduciary and has a duty to act primarily for the benefit of its clients. While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or investment adviser representative shall not engage in dishonest or unethical conduct including the following:

...

(A) Recommending to a client, to whom investment supervisory, management, or consulting services are provided, the purchase, sale, or exchange of a security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

**NOTICE OF CHARGES**

YOU ARE HEREBY NOTIFIED of the following allegations:

**Parties and Jurisdiction**

1. Wilson Advisory Group, LLC ("Wilson Advisory") is a limited liability company organized under the laws of Colorado with a principal place of business at 390 Union Blvd., Suite 310 in Lakewood, Colorado. Wilson Advisory is an investment adviser firm licensed in the states of Colorado and California.

2. Jeff M. Wilson ("Wilson") is an adult male individual with a business address on file with the Division of Securities ("Division") of 390 Union Blvd. Suite 310, in Lakewood, Colorado and a residential address of 6740 East Cedar Avenue, Unit B in Denver, Colorado. Wilson is an investment adviser representative affiliated with Wilson Advisory. Wilson is also the president, control person, and registered agent for Wilson Advisory. Wilson is licensed in the state of Colorado as an investment adviser representative.

3. Pursuant to §§ 11-51-410(1) and 703(1), C.R.S., the Securities Commissioner has jurisdiction over Wilson Advisory and Wilson (collectively "Respondents") and the subject matter of this proceeding.

**Related Entities**

4. Fidelity Investments ("Fidelity") is a broker-dealer with a principal place of business at 82 Devonshire Street, Boston, MA 02109. Fidelity was the custodian broker-dealer that maintained custody of the financial instruments and securities that Wilson managed on behalf of his investment advisory clients as an investment adviser. Fidelity is licensed in the state of Colorado as a broker-dealer.

### **Summary of the Allegations**

5. From approximately May 2006 to September 2009, Wilson through Wilson Advisory was the investment adviser representative for Colorado residents WL and RL. Around February 2008, Wilson recommended and purchased unsuitable securities for RL in the form of leveraged-inverse exchange traded funds. Wilson had no reasonable basis in which to recommend the leveraged-inverse exchange traded funds for RL, as they are complex, non-traditional, speculative, and highly risky investments that seek daily return objectives and are not intended to be held for an extended period of time. Following these purchases in February 2008, Wilson then recommended and purchased additional shares of leveraged-inverse exchange traded funds for RL and WL in February 2009 and May 2009. As a consequence, RL and WL held positions in leveraged-inverse exchange traded funds for approximately a year and a half and incurred substantial losses in the amount of \$56,043.05.

### **Statement of Facts**

#### **Exchange Traded Funds**

6. Exchange Trade Funds (“ETFs”) are investment vehicles that allow an investor to buy and sell shares in a single security that represents a fractional ownership of a portfolio of securities that track an index, a commodity, or a basket of assets like an index fund. ETFs provide investors much of the same benefits as mutual funds, but differ because, unlike most mutual funds, ETFs trade like typical stocks. This provides investors with considerable flexibility and lower fees.

7. The risks associated with ETFs are often hidden and not properly understood by non-institutional investors. Some ETFs are designed to invest as if the investor is using borrowed funds (known as “leveraged ETFs”) which deliver multiples of the daily performance of the index or benchmark that it tracks. Other ETFs are designed to capitalize on the opposite direction of the market or index (known as “inverse ETFs”) and are marketed as a way to profit from or hedge their exposure to downward moving markets. Leveraged, inverse, or leveraged-inverse ETFs not only seek to capitalize on the movement of a market or index, but do so primarily utilizing exotic financial instruments, such as futures or swaps contracts. Most leveraged and inverse ETFs reset each day, which means they are designed to achieve their stated objective on a daily basis.

8. One of the overlooked risks associated with ETFs is the compounding over time of the daily returns that ETFs are designed to achieve. Investors who purchase ETFs should be made aware and should be willing to assume the risk that the long-term performance of an ETF may be vastly different than that of the ETF’s benchmark index. Investors must be made aware and understand the risk that while an ETF is supposed to return 200% of an index’s return, the investor’s position in the EFT may actually decline in value, even though the index has risen.

9. Because some leveraged-inverse ETFs seek daily returns, the products can create unpredictable returns even when they successfully achieve their stated daily objective day after day. When held for periods longer than one day, volatility present in the index the leveraged-inverse EFT tracks skews the overall returns, even when the index or sector moves in the general

direction the purchaser predicted or expected. The greater the volatility in the market during the course of time, the more likely the leveraged-inverse EFT will produce an extreme or unpredictable result.

10. For example, on Day 1, if the index declines 10%, then a \$100 investment in the index declines \$10 to \$90. With a leveraged (times 2) ETF, the \$100 investment declines \$20 to \$80. On Day 2, the index increases 10%, then the index investment increases \$9 to \$99. The leveraged (times 2) ETF increases \$16 to \$96. The index has a return of -1%, while the leveraged ETF has a return of -4%. The risk is due to the compounding effects of the daily returns generated by the leveraged-inverse ETFs for each day during the one-month period that the investor holds his position.

11. In June 2009, the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization registered with the Securities & Exchange Commission, issued Regulatory Notice 09-31 entitled "Non-Traditional ETFs" ("FINRA Notice"). The FINRA Notice reminded firms of their obligations related to leveraged and inverse ETFs.

12. In the FINRA Notice, the Executive Summary states as follows: ETFs that offer leverage or that are designed to perform inversely to the index or benchmark they track - or both - are growing in number and popularity. While such products may be useful in some sophisticated trading strategies, they are highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis. Due to the effects of compounding, their performance over longer periods of time can differ significantly from their stated daily objective. Therefore, inverse and leveraged ETFs that are reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets.

### **The Investment Advisory Relationship Between Wilson and RL and WL**

13. In or around May 2006, Colorado residents WL and RL, husband and wife, entered into an agreement for Wilson to become their investment adviser through Wilson Advisory. WL and RL were approximately 80 and 65, respectively, at the time they became investment advisory clients of Wilson. Wilson was a friend of one of RL and WL's children.

14. Upon information and belief, prior to Wilson becoming WL and RL's investment adviser representative, RL and WL completed certain paperwork related to their financial background, investment history, and risk tolerance. The paperwork completed by WL and RL revealed the following:

- a. WL had been a physician who had been on total disability for approximately twenty years.
- b. The main source of income for WL and RL was social security benefits, as well as a disability policy for WL. The monthly income for WL and RL in May 2006 was approximately \$6,400.
- c. WL and RL's monthly household expenditures were approximately \$5,200.

d. WL and RL had approximately \$66,150 in various stocks and bonds that they held themselves, \$251,376 in mutual funds and/or other brokerage accounts, \$560,000 in life insurance policies, and \$129,250 in annuities.

e. WL and RL indicated they wanted to preserve their capital, and earn enough money to live comfortably and be financially independent, while also help grandchildren with higher education expenses, give to charity, and have monies to bequeath to their three children.

15. On May 25, 2006, WL and RL met with Wilson and entered into a Money Management Engagement with Optional Financial Planning Agreement ("IA Agreement") with Wilson through Wilson Advisory. The IA Agreement indicated that WL and RL's primary investment objective was preservation of capital, followed by growth of capital and then absolute return. The investment strategies included 30% income, 40% valuation, and 30% Wilson Advisory Group Model. The performance benchmark was 100% absolute return. The IA Agreement covered both money management and financial planning services.

16. The IA Agreement described the "income strategy" as "positions are targeted to be held for 6 months to 5 years. The primary objective is stability of principal over a one to three year time horizon after taxes and inflation, with the secondary objective being income."

17. The IA Agreement described the "valuation strategy" as "positions are targeted to be held for 4 months to 18 months. The objective is to purchase bonds or equities that are, in our evaluation, below market or replacement cost, or where the company or industry has increasing demand that supports current or better pricing power."

18. The IA Agreement described the "Wilson Advisory Group Model" as "positions are targeted to be reallocated on a monthly basis, although some positions may be held for 12 months or longer. The objective is to use the Wilson Advisory Group, LLC Proprietary Model that utilizes traditional historical relationships and patterns to identify advancing and retreating markets. Investments will be in index or enhanced index funds, which represent sectors that our model determines to possess favorable performance potential. When our model turns negative, we may short those indexes to move to cash, bonds, or other liquid investments."

19. The IA Agreement set forth compensation of the money management services to be on a quarterly basis and would be 0.375% of the assets under management. The compensation for the financial planning services was a flat rate of \$2,500 to be paid in five installments of \$500 with the first payment due upon the signing of the IA Agreement and the remaining installments due over the next four months.

20. Early on in the relationship, it was discussed between Wilson and RL that while WL signed all the paperwork, that RL would be primarily responsible for any discussions with Wilson on behalf of the couple because WL had been diagnosed with Alzheimer's.

21. Early on in the relationship, it was discussed that because RL and WL did not have any pensions, besides their Social Security and disability income, they needed their investments to grow in order to live on the monies earned and to prevent loss of principal.

22. RL hired Wilson because she needed a financial planner to assist her with investment advice and financial decisions, as she did not have the background or expertise to handle such matters. RL relied on Wilson completely and did not actively monitor her accounts because she assumed she had hired Wilson to manage her investments and make the necessary and appropriate financial decisions.

### **Creation of the Financial Plan for RL and WL**

23. Beginning in June 2006 through October 2006, RL and WL paid Wilson in five installments of \$500 for a total of \$2,500 to create a financial plan for them.

24. On July 25, 2006, Wilson provided WL and RL with a Financial Needs Analysis Report ("FNA Report"). In the FNA Report, some of the financial information about WL and RL was reflected:

- a. WL and RL had investment assets totaling \$788,184 with a primary residence valued at market value at \$260,000 for a total net worth of \$1,048,184.
- b. WL and RL had a cash flow of \$74,628 from Social Security and disability payments and investment income of \$32,299 for an annual income of \$106,927.
- c. WL and RL's current portfolio consisted of almost 70% cash, cash equivalents or bonds.
- d. Wilson indicated that WL and RL's portfolio had "too much cash to properly plan for long-term contingencies for [RL]." Wilson indicated that with the current environment of rising inflation and interest rates, there was "serious long-term risks to [their] financial security."
- e. Wilson indicated that "[WL and RL] need to consider [their] 'stomach' for short-term losses while making certain that [their] long-term needs are properly provided for."
- f. WL and RL wanted to establish an investment plan to save for several major purchases including: hearing aids, a new deck, a new toilet, heating and A/C.

25. In the FNA Report, the following action plan was recommended by Wilson:

- a. Wilson recommended a plan that would increase WL and RL's net worth to \$1,120,310 from the current net worth of \$1,048,184.
- b. In order to increase their net worth, Wilson recommended that WL and RL consolidate their investment accounts to Fidelity.
- c. Wilson recommended using the Wilson Advisory Income, Value, and Tactical Strategies to maximize their potential return while minimizing potential losses. Wilson noted that, "while higher potential earnings carry greater risk of loss, this will

provide additional cushion for medical expenses, and enhance [WL and RL's] ability to help [their] children and grandchildren..."

d. Wilson recommended that WL and RL take the 10% penalty free withdrawals from their annuities to diversify their portfolio.

e. Wilson recommended that WL and RL buy the major purchases noted in the FNA Report.

f. Wilson noted that WL and RL should maintain a "long-term focus" for their plan and that their financial plan was not a "single event but a journey that may cover ten, twenty, and thirty years or longer."

26. WL and RL acknowledged delivery of the FNA Report on the same day of July 25, 2006.

27. Following the July 2006 meeting, Wilson established an action plan that included taking specific steps with respect to RL and WL's life insurance and long-term care coverages, making adjustments to RL and WL's annuities, reviewing estate planning needs, reviewing and creating a plan for six months-worth of living expenses, and consolidating their investment accounts to Fidelity.

28. Commencing in July 2006, Wilson began billing RL and WL in quarterly installments for his investment advisory fees. Wilson was compensated at a rate of 0.375% for the assets he had under management for RL and WL. From July 2006 to the termination of the investment advisory relationship in September 2009, RL and WL paid Wilson investment advisory fees ranging from \$400 to \$1,000 per quarter. There were some quarters throughout their relationship Wilson did not charge RL and WL an investment advisory fee.

29. While RL did not want to transfer her mutual fund assets to Fidelity, she agreed to do so based upon the advice of Wilson.

30. Around August 2006, WL and RL's investment assets in the amount of \$249,534.23 were transferred from their previous brokerage accounts to Fidelity, as the custodian for Wilson through Wilson Advisory. The majority of the balance in the Fidelity account was comprised of mutual funds with some stock positions.

31. Following the transfer of investment assets to Fidelity in August 2006, Wilson conducted general investment advisory services for RL and WL that included completing paperwork associated with the establishment of RL and WL's account at Fidelity, discussing issues related to RL and WL's annuities, and resolving some issues surrounding student loans for one of RL and WL's children.

32. In February-March 2007, Wilson sold off all of RL and WL's stock and mutual fund holdings, except their stock in Softnet Technology Corp. and their position in the Franklin Income Class A mutual fund ("Franklin"). As of March 31, 2007, the majority of RL and WL's account consisted of cash in the amount of \$201,554.95.



33. Around March 6, 2007, Wilson and RL spoke on the telephone and Wilson notified her that all her positions were sold and that he would reposition her cash into ProShares, which ended up being the leveraged-inverse exchange traded funds ("ETFs").

34. On January 14, 2008, Wilson sent RL her 4<sup>th</sup> Quarter Report for 2007 with a cover letter. In the cover letter, Wilson indicated that index investors, of which RL was not one, lost last year's gain and there remained challenges outstanding that might drive the markets even lower. He stated, "This is why we remain cautious. Our conservative approach has proved wise."

### **The First Purchase of Leveraged-Inverse ETFs in February 2008**

35. Prior to February 2008, RL had been unhappy with Wilson's handling of her investment account. Any gains RL received from August 2006 to March 2007 were a result of positions that she previously purchased and that were consolidated and transferred to Fidelity. Any gains RL received from March 2007 to February 2008 were a result of interest earned on the cash in her account, which comprised the majority of her assets.

36. From March 2007 to February 2008, Wilson did not reposition any of RL's cash as a result of the sale of her mutual fund and stock positions until he purchased on her behalf 166 shares of ProShares TR Ultra Short Russell 2000 ("ProShares Russell") and 220 shares of ProShares TR Ultra Short MD Cap 400 FD ("ProShares Cap") on February 22, 2008.

37. At the time Wilson purchased the shares of ProShares Russell and ProShares Cap in February 2008, RL did not understand the characteristics of the investment product or the risks associated with leveraged-inverse ETFs.

38. At the time Wilson purchased the shares of ProShares Russell and ProShares Cap in February 2008, Wilson did not explain or disclose the risks associated with leveraged-inverse ETFs.

39. At the time Wilson purchased the ProShares Russell and ProShares Cap in February 2008, Wilson did not have a reasonable basis to believe the recommendation of those positions were suitable for RL or WL.

40. After the purchase of the ProShares Russell and ProShares Cap, RL's investment portfolio was comprised of approximately 10% in ETFs and 90% cash or cash equivalents.

41. Also in February 2008, RL was in a car accident and she withdrew \$20,000 from her investment account for the purchase of a new car.

42. Following the purchases of the shares in ProShares Russell and ProShares Cap in February 2008, and with the \$20,000 withdrawal for the purchase of her car, RL had a remaining cash balance of \$157,532.76 at Fidelity.

43. On October 30, 2008, RL withdrew an additional \$10,000 from her Fidelity account for general living expenses.

44. On July 11, 2008, Wilson sent RL her 2<sup>nd</sup> Quarter Report for 2008 with a cover letter. In the cover letter, Wilson indicated that he had been “very cautious” about investing in the stock market, and that he recommended keeping the majority of her funds in the money market account. Wilson also indicated that the ETFs, which comprised approximately 10% of her portfolio had performed very well. July 11, 2008 letter from Wilson also stated that when their outside adviser, STIR Research directs Wilson, he will sell the positions in the leveraged-inverse ETFs positions.

45. On October 13, 2008, Wilson sent RL her 3<sup>rd</sup> Quarter Report for 2008 with a cover letter. In the cover letter, Wilson indicated that approximately 90% of RL’s portfolio was in a money market account because it was “safe, and is now backed up by a Federal guarantee.” Wilson acknowledged that the markets have experienced “more volatility” than ever before. With respect to the leveraged-inverse ETF positions, Wilson indicated that he is “expecting at least one more major market drop in the next 2 to 6 months, at which time, we will sell these short positions.”

#### **The Second Purchase of Leveraged-Inverse ETFs in February 2009**

46. On January 12, 2009, Wilson sent RL her 4<sup>th</sup> Quarter Report for 2008 with a cover letter. In the cover letter, Wilson acknowledged that, “we should expect tough times and volatility as we face the worst financial collapse since the 1930’s.”

47. Despite the statements made in his January 12<sup>th</sup> letter acknowledging the volatility of the markets, Wilson purchased 166 shares of ProShares Russell and 220 shares of ProShares Cap on February 2, 2009. These shares were in addition to the shares previously purchased in February 2008.

48. At the time Wilson purchased the additional shares of ProShares Russell and ProShares Cap in February 2009, RL did not understand the characteristics of the investment product or the risks associated with leverage-inverse ETFs.

49. At the time Wilson purchased the shares of ProShares Russell and ProShares Cap in February 2009, Wilson did not explain or disclose the risks associated with leveraged-inverse ETFs.

50. At the time Wilson purchased the ProShares Russell and ProShares Cap in February 2009, Wilson did not have a reasonable basis to believe the recommendation of those positions were suitable for RL or WL.

51. After the purchase of the additional shares of ProShares Russell and ProShares Cap in February 2009, RL’s investment portfolio was comprised of approximately 26.33% ETFs and the remainder in cash or cash equivalents.

52. On March 6, 2009, Wilson recommended that RL sell her remaining position in her Franklin mutual fund. Based upon his recommendation RL agreed to sell her positions in Franklin on March 9, 2009.

53. From March 2009 to May 2009, RL incurred losses associated with her positions in the leveraged-inverse ETFs.

54. On April 17, 2009, Wilson sent RL her 1<sup>st</sup> Quarter Report for 2009 with a cover letter. In the cover letter, Wilson acknowledged that while the markets have rebounded from March 2009 and that experts predict the markets have bottomed, he remained “very concerned about the investment market and our economy.” With respect to her leveraged-inverse ETFs, and his strategy, he stated, “I expect one more big drop in the markets as we approach the historically weakest time of year, May through October. I plan to take advantage of this by increasing the short positions after we begin to fall from the current short-term bear market rally peak. Using technical analysis, we will go short as the markets begin their fall, and will sell these positions when they inevitably rebound.” He explained that day-traders, hedging and speculators had increased and that since November 2007, the markets rapid movements down with equally rapid movements up required a 30 to 60 day focus on the equity (stock) portion of her portfolio.

55. At the time he wrote this, RL only had one small stock holding in Softnet with the remainder of her portfolio in cash, cash equivalents or leveraged-inverse ETFs.

### **The Third Purchase of Leveraged-Inverse ETFs in May 2009**

56. Based upon the strategy reflected in his April 17, 2009 letter to RL, on May 19, 2009, Wilson purchased 498 shares of ProShares Russell and 660 shares of ProShares Cap. These shares were in addition to the shares previously purchased in February 2008 and February 2009.

57. At the time Wilson purchased the additional shares of ProShares Russell and ProShares Cap in May 2009, RL did not understand the characteristics of the investment product or the risks associated with leveraged-inverse ETFs.

58. At the time Wilson purchased the shares of ProShares Russell and ProShares Cap in May 2009, Wilson did not explain or disclose the risks associated with leveraged-inverse ETFs.

59. At the time Wilson purchased the ProShares Russell and ProShares Cap in May 2009, Wilson did not have a reasonable basis to believe the recommendation of those positions were suitable for RL or WL.

60. After the third purchase of the additional shares of ProShares Russell and ProShares Cap in May 2009, RL’s investment portfolio was comprised of approximately 79.41% in ETFs and the remainder in cash or cash equivalents. The total amount held by RL in ProShares Russell and ProShares Cap was \$80,129.

61. Around the same time period that Wilson purchased the third round of ProShares Russell and ProShares Cap, RL withdrew an additional amount of \$100,000 from her Fidelity account. Following the purchase of the additional ProShares and the withdrawal of \$100,000, RL had a remaining cash balance of \$20,772.20

62. RL cites the fact that Wilson had not made any substantial gains for her in the management of her money, and in fact, incurred losses with the purchase of the two ETFs, as reasons for why she withdrew \$100,000 from her account.

63. RL purchased some CDs that earned approximately 6.75% return with the money she withdrew from Fidelity because she felt that CDs were a safe investment and offered guaranteed returns.

64. The FINRA Notice related to ETFs issued in June 2009 reminded members of its suitability obligations with respect to the recommendations made to client who purchase ETFs. Given the complexity and unpredictable returns of ETFs, the FINRA Notice indicated that “[w]hile the customer-specific suitability analysis depends upon the investor’s particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets.”

65. Despite the FINRA Notice, Wilson did not reposition the leveraged ETFs held by RL.

66. Following the third purchase of the leveraged-inverse ETFs, the markets continued to recover and go up. As a result, from June 2009 to September 2009, RL incurred additional losses associated with her leveraged-inverse ETFs positions. The losses incurred from June to September 2009 were \$-3,179.78, \$-13,213.26, \$-5,363.16, and \$-8,630.80, respectively.

#### **The Termination of the Investment Advisory Relationship**

67. On or around September 11, 2009, Wilson informed RL that he would be selling her positions in the leveraged-inverse ETFs. The ProShares Russell and ProShares Cap were sold on September 28, 2009. RL and WL incurred combined losses from the sale of the ProShares Russell and ProShares Cap of \$56,043.05, as they were sold at a time when the market was going up.

68. In or around the same time period of September 2009, Wilson informed RL that he could no longer assist her with her investment advisory needs. As a result, RL requested that her account with Wilson be closed.

69. In or around October 1, 2009, Wilson issued a check to RL in the amount of \$70,475.49, which represented the remainder of her balance in the Fidelity account after the losses incurred from the ProShares Russell and ProShares Cap positions, and her overall withdrawals of \$130,000.

70. When RL came to the office to pick up her check, Wilson would not meet with her personally but had an office clerk give her the check.

**FIRST CLAIM**  
**Unfair and Dishonest Dealings**  
**Unsuitability**  
**(§ 11-51-410(1)(g), C.R.S., and**  
**Commissioner Rule 51-4.8(1A).A.)**

71. Paragraphs 1 through 70 above are incorporated herein by reference.

72. Wilson recommended through Wilson Advisory the purchase of the leveraged-inverse ETFs for the account of WL and RL without reasonable grounds for believing that the recommendation was suitable for WL and RL based upon the information furnished by the investor after reasonable inquiry concerning the WL and RL's investment objectives, financial situation, and needs in violation of Commissioner Rule 51-4.8(1A).A.

73. Wilson Advisory and Wilson did not have reasonable grounds for believing the recommendations were suitable for RL and WL to invest in ProShares Russell and ProShares Cap leveraged-inverse ETFs based upon the following non-exclusive factors and information:

- a. RL and WL were elderly individuals who are not institutional investors;
- b. RL and WL had limited income streams through monthly Social Security and disability payments;
- c. RL and WL made clear to Wilson both verbally and in the IA Agreement that they are conservative investors, as their primary investment objectives was preservation of capital with modest growth of income;
- d. RL and WL were not interested in short-term speculative and risky investments because they did not want any loss of principal;
- e. WL was not capable of making any financial or investment related decisions based upon his diagnosis of Alzheimer's;
- f. RL and WL did not have the investment experience, sophistication or understanding of the characteristics or risk associated with investing leveraged-inverse ETFs;
- g. Wilson was aware of the conservative investment objective of RL based upon conversations with RL and WL, the IA Agreement, and Wilson's acknowledgement in his correspondences to RL;
- h. Leveraged-inverse ETFs are meant to be held for a short time period, as the returns re-set on a daily basis. Wilson intended to use the positions in the leveraged-inverse ETFs as a hedge against her cash or cash equivalents positions. Yet, RL held some of her positions in the leveraged-inverse ETFs for five months to a year and a half;

i. Because the majority of RL and WL's portfolio was in cash or cash equivalents, it was not suitable to utilize a highly risky and speculative investment like leveraged-inverse ETFs to hedge against cash holdings;

j. Wilson failed to investigate or explore the daily tax consequences of leveraged-inverse ETFs to realize significant short-term capital gains RL might incur that might not have been off-set by a loss;

k. With respect to the second and third purchases of leveraged-inverse ETFs, in February 2009 and May 2009, Wilson acknowledged the volatility of the markets in correspondence to RL prior to the purchase dates, and yet he purchased more positions even though the returns on leveraged-inverse ETFs may have unpredictable or wildly different results in volatile markets; and

l. With respect to the third purchase of leveraged-inverse ETFs in May 2009, the market had already recovered from March 2009 and was going up when Wilson purchased 498 shares of the ProShares Russell and 660 of the ProShares Cap in May 2009, which is counter-intuitive and not suitable given an investor in a leveraged-inverse ETF only makes a return when the market goes down.

74. The conduct of Wilson through Wilson Advisory constitutes a violation of Commissioner's Rule 51-4.8(IA).A that prohibits unfair and dishonest dealings in violation of § 11-51-410(1)(g), C.R.S., and constitutes grounds for the imposition of sanctions against Wilson and Wilson Advisory pursuant to § 11-51-410(1), C.R.S., including suspension or revocation of Wilson's investment adviser representative license and Wilson Advisory's investment adviser license. In addition, pursuant to § 11-51-704(2), C.R.S., these sanctions are necessary and appropriate in the public interest and consistent with the purposes and provisions of the Act.

**SECOND CLAIM**  
**Breach of Fiduciary Duty**  
**(§ 11-51-410(1)(g), C.R.S., and**  
**Commissioner Rule 51-4.8(1A))**

75. Paragraphs 1 through 74 above are incorporated herein by reference.

76. At all times relevant hereto, Wilson Advisory and Wilson were licensed as an investment adviser and investment adviser representative, respectively, and therefore were fiduciaries to RL and WL. As a fiduciary, Wilson was required to act solely in the interests of RL and WL with the same care, skill, prudence and diligence of a prudent investment adviser in like situations, including giving appropriate consideration to the facts and circumstances that an adviser should know are relevant to a particular investment, as well as the role the investment plays in RL and WL's financial plan. Appropriate consideration includes a determination by Wilson that the particular investment is reasonably designed to further the purposes of RL and WL's financial plan.

77. By engaging in the conduct set forth above, Wilson and Wilson Advisory breached their duty to act with the appropriate duty of care, and engaged in dishonest or unethical conduct in violation of Commissioner's Rule 51-4.8(IA).

78. The conduct of Wilson through Wilson Advisory constitutes a violation of Commissioner's Rule 51-4.8(IA) that prohibits unfair and dishonest dealings in violation of § 11-51-410(1)(g), C.R.S., and constitutes grounds for the imposition of sanctions against Wilson and Wilson Advisory pursuant to § 11-51-410(1), C.R.S., including suspension or revocation of Wilson's investment adviser representative license and Wilson Advisory's investment adviser license. In addition, pursuant to § 11-51-704(2), C.R.S., these sanctions are necessary and appropriate in the public interest and consistent with the purposes and provisions of the Act.

WHEREFORE, the Staff for the Colorado Division of Securities respectfully requests that the Administrative Law Judge enter an initial decision revoking, suspending, or otherwise imposing conditions upon the investment adviser license of Wilson Advisory and the investment adviser representative license of Wilson pursuant to § 11-51-410(1), C.R.S., and for such other and further relief as the Administrative Law Judge deems just and proper.

Dated this 8<sup>th</sup> day of March, 2013.

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